

**MINUTES
of the
THIRD MEETING
of the
CAPITAL OUTLAY SUBCOMMITTEE
of the
NEW MEXICO LEGISLATIVE COUNCIL
and the
LEGISLATIVE FINANCE COMMITTEE**

**September 2, 2008
Room 307, State Capitol
Santa Fe**

The third meeting of the Capital Outlay Subcommittee of the New Mexico Legislative Council and the Legislative Finance Committee for 2008 was called to order at 10:50 a.m. by Speaker of the House Ben Lujan in Room 307 of the State Capitol in Santa Fe. Since there was not a quorum present for the meeting, the group met as a subcommittee.

Present

Rep. Ben Lujan, Co-Chair
Sen. Carlos R. Cisneros
Sen. Dianna J. Duran
Rep. Henry Kiki Saavedra
Rep. Edward C. Sandoval
Rep. Jeannette O. Wallace
Rep. Teresa A. Zanetti

Absent

Sen. Timothy Z. Jennings, Co-Chair
Sen. Kent L. Cravens
Sen. Carroll H. Leavell
Rep. W. Ken Martinez
Rep. Brian K. Moore
Sen. Leonard Lee Rawson
Sen. Michael S. Sanchez
Sen. John Arthur Smith
Rep. Thomas C. Taylor

Advisory Members

Rep. Janice E. Arnold-Jones
Rep. Rhonda S. King
Sen. H. Diane Snyder

Sen. Stuart Ingle

Staff

Ric Gaudet, Legislative Council Service (LCS)
Renée Gregorio, Capital Outlay, LCS
Jeannae Leger, Legislative Finance Committee (LFC)
Sarah Lucero, LFC
Tom Pollard, LCS
Paula Tackett, Director, LCS
Ralph Vincent, Consultant, LCS

Guests

The guest list is in the meeting file.

Handouts

Copies of handouts given by meeting presenters are in the meeting file.

Tuesday, September 2

Collaboration, Information-Sharing, Resources and Issues Involving the Capital Database

Mr. Vincent gave a presentation about the current information processes and databases the legislature and executive use to appropriate and monitor capital outlay projects. Mr. Vincent described a possible change to the appropriation process that would allow legislators to collaborate in funding projects. However, that would require some political changes to the process. Sometimes the legislature overfunds or underfunds projects because not enough information is readily available to legislators during the funding process. Allowing legislators to see how much money a particular project has received will allow them to make better decisions, he said.

Representative Arnold-Jones suggested that the capital database be changed so that multiple requests for the same project reflect the amount actually needed for the project, rather than the total amount requested from the various requests. Mr. Vincent said that change is already being implemented. She also said that legislators would have to grant permission for others to gain access to their confidential requests.

Senator Snyder said that she tries to communicate with the house members in her district about projects, but there is not always enough time. She asked whether the system could reflect real-time funding of projects. Mr. Vincent said that change is possible, but would require changes in the funding process. Senator Snyder recounted a project that needed \$180,000 but actually got funding of \$480,000 because the legislators who funded the project did not know that others were also funding the project.

Ms. Tackett said that if the subcommittee wants to proceed with the capital outlay collaboration idea, the LCS can return at a later meeting with a more detailed plan for the members' consideration. Ms. Gregorio said that if there were more time available during the funding process, collaboration could be easier.

State Agency Auditing Process

Local Government Audits

State Auditor Hector Balderas and Manu Patel of the LFC gave a presentation to the subcommittee about the audit process for state and local governments. The Audit Act is the main statutory authority for the State Auditor's Office (SAO) to oversee the audits of all state agencies and political subdivisions of the state, including quasi-governmental entities created by the legislature. Each entity is required to perform a financial audit of its affairs every year, but the SAO does not have enough staff to ensure that the approximately 700 audits are done each

year, nor does it have the statutory authority to enforce the audit requirement.

Many times, small governments get behind schedule with their audits and do not have the resources to pay for them, said State Auditor Balderas. The requirement for a full financial audit every year is difficult for many local governments, because the cost to hire a private auditor may be too large a portion of that government's annual budget. For example, some water systems have an annual budget of \$80,000, and an audit for that water system usually costs at least \$10,000. In addition, since there are only 50 private firms that provide governmental auditing services, it can be impossible for a small rural government to get an auditor to perform auditing services. State Auditor Balderas said that the legislature will need to decide whether to increase the staff of the SAO to allow it to perform more audits for local governments, or whether to change the audit requirements for small entities. An acequia association should not be audited at the same level as the City of Albuquerque, he said.

State Auditor Balderas described the different types of audits performed by the SAO and the LFC. The first type is a financial audit, which is required to be performed each year by every governmental entity. A financial audit assesses the legality and propriety of an agency's expenditures, the adequacy of its accounting and internal control systems and the fairness of its financial statements. The SAO will ask the legislature for more flexibility to determine if some entities can have different audit requirements than a costly full financial audit each year. The SAO also has the ability to perform special and fraud audits at any time of the year. Any illegal activity that is detected gets reported to the proper law enforcement jurisdiction. The last type of audit, performance audits, are done by the LFC. The LFC conducts about 10 performance audits each year, which rate program effectiveness and make recommendations for improvement.

To address the problem that local governments are facing with audits, State Auditor Balderas established the State Auditor's Task Force on Rural Accountability in July 2008. The task force has met in Santa Fe, Las Cruces and Taos, and has heard testimony from many types of small local governmental entities, certified public accountants (CPAs) and the public. The task force will make recommendations to the state auditor in October. Any proposed changes in the law will be submitted to the legislature.

Capital Outlay

State Auditor Balderas said that the SAO does not provide general oversight of capital outlay projects unless there is fraud involved or if the project involves the general financial aspects of the agency. He said that the SAO is open to legislative direction to audit capital projects.

Mr. Patel said that the LFC in the past has identified deficiencies in oversight and management of capital projects by agencies. He also said that the Department of Finance and Administration (DFA) could improve its administration of the Capital Projects Unit. The process has become better in the past few years, but there is still a need for a consolidated master planning process and a better use of state resources. The current system of including capital projects in an agency's annual financial statement may not provide sufficient coverage of the

projects. He suggested that the LFC and SAO jointly perform a few audits of large capital projects in order to develop a set of procedures for future capital audits.

Subcommittee Discussion

Representative Saavedra said that the legislature may need to provide funding to the SAO to perform audits for small governmental entities that cannot afford them. Speaker Lujan agreed and said that more assistance needs to be given to small cities and counties for auditing. Mr. Patel said that many states have separate divisions in the state auditor's offices dedicated to performing audits for local governments. That would require increased funding, he said.

Senator Cisneros asked if acequia associations are required to perform annual audits. Most acequia associations have very small budgets and certainly could not afford a \$10,000 audit. State Auditor Balderas said that many small entities are reluctant to spend capital outlay dollars, because once they do, they become subject to the Audit Act.

Representative Zanetti asked about the SAO's ability to enforce the Audit Act. State Auditor Balderas said the SAO has no enforcement or sanctioning power to ensure annual audits are completed. Representative Zanetti asked whether local governments can bundle several audits into one package to save money. State Auditor Balderas said that since each entity is required to audit its books, each auditor must report only on one entity at a time. He said the task force is considering recommending that the SAO be given the flexibility to determine what is an appropriate audit. Bundling of audits could then become possible.

Senator Snyder suggested that CPAs should be able to contract with many entities to do their audits at a level less than the full financial audit, but that a few of those entities still need to be fully audited. State Auditor Balderas said that the task force has actively sought input from CPAs to expand the pool of government auditors. Senator Snyder asked whether the reluctance of small governmental entities to do their audits is related to a lack of training. State Auditor Balderas said that many people think that audits only happen when something is wrong, when, in fact, local governments need to complete audits every year. He suggested that universities provide specific training geared toward financial managers of New Mexico local governments.

Senator Snyder said that she is wary of rewarding small governments that have not managed their financial affairs correctly by exempting them from the full audit requirement. State Auditor Balderas responded by saying that most other states exempt local governments from performing full financial audits, or they are audited by a state local government division. He said that he wants to focus resources toward areas where there is a material risk. He does not want to exempt small governments from auditing requirements, but he wants the flexibility to determine what type of audit a local government needs to perform.

Representative Saavedra suggested that auditors that currently work in state agencies should be transferred to the SAO, so that they can be independent of the agency they are supposed to be monitoring. He also asked what agency is responsible to audit the organization that operates the Low Income Home Energy Assistance Program. State Auditor Balderas said

that the Human Services Department is responsible for that program. He said his staff will look into that program.

Representative Wallace said that many small communities have no gross receipts tax base and are unable to raise their user fees for water and sewer hookups because they are required to charge equitable fees to their users. She said that those small communities need assistance with their audits.

Senator Duran asked how many auditors are employed by state agencies. Mr. Patel said that the LFC will find out that answer and report back to her.

Certification and Reimbursement Process

Robert Apodaca, director, Local Government Division (LGD), DFA, and Antonio Ortiz of the Public Education Department (PED) described to the subcommittee their agencies' certification and reimbursement process for capital outlay projects. Mr. Apodaca began with the certification process, which ensures that a funded project is ready to begin and complies with all the statutory requirements for a project, including the ownership and operation of the project. He said that the LGD now submits general fund certification questionnaires to local governments at the same time severance tax bond (STB) certifications are sent out by the State Board of Finance (SBF). In the past, general fund projects have not always had the same up-front scrutiny as STB projects. Once a project is certified by the local entity or state agency, a grant agreement between the LGD and the entity is signed, and the appropriation is budgeted. The LGD reimburses entities within 15-20 days after receiving a request, making sure that the reimbursement request complies with the appropriation language. The SBF processes reimbursement requests twice per month and deposits reimbursements by wire transfer.

Mr. Apodaca said that LGD project managers are trying to meet with local government officials to identify those projects on their Infrastructure Capital Improvement Plans (ICIPs) that are actually ready to proceed.

Representative Sandoval said that new projects should only get planning and design money first and then construction money later.

Representative Saavedra suggested that the Bernalillo County legislative delegation meet with county and Albuquerque officials to discuss capital projects. He said the legislature should not fund projects that the governmental entity cannot operate.

Mr. Ortiz discussed the PED's reimbursement process for appropriations. He said that every year 20 percent of funded projects receive a site visit from PED staff to ensure compliance with legislative intent. Since 2004, PED staff have been able to reduce the backlog of outstanding projects from eight years outstanding to now only having current projects on the books.

Representative Arnold-Jones said that Albuquerque Public Schools (APS) has a disconnect between projects and the reimbursement process. Mr. Ortiz said that APS batches its reimbursement requests, which can lead to discrepancies between PED's reporting on projects and the actual status of those projects. This can lead to even more problems when a project that is completed but is reported as being stalled gets reauthorized by the legislature. Mr. Ortiz said that APS used to batch its reimbursement requests once per year, but is now doing quarterly batches. The PED is able to process reimbursements at any time and does not require school districts to batch.

Representative Sandoval said that APS representatives should come to the next subcommittee meeting to discuss its capital outlay reimbursement process.

Speaker Lujan asked about offsets from direct legislative appropriations to school construction awards made by the Public School Capital Outlay Council (PSCOC). Mr. Ortiz said that certain amounts appropriated by the legislature for a school district will be reduced in future awards granted by the PSCOC. That provision of law is intended to ensure equitable funding for school construction projects.

Representative Sandoval said that sometimes school districts will reject legislative appropriations in order to avoid the offsets. That appropriated money then goes into limbo and will need to be reauthorized, he said.

Speaker Lujan asked whether appropriations for books and computers are factored into the offset. Ms. Tackett said that they are. The PSCOC needs to take into account all direct appropriations. However, the offset amount is 50 percent of the appropriation amount, she said.

Requirements and Restrictions for Nonprofit Entities

Judith Amer, general counsel for the DFA, and Ms. Tackett gave a presentation to the subcommittee about capital outlay expenditures for nonprofit entities. Ms. Amer began by reviewing New Mexico's constitutional provisions that generally prohibit donations to individuals or entities not under the control of the state. The key issue arises in considering what a donation is. If the state is receiving something in return for its appropriation, that is not a donation, said Ms. Amer. However, the value returned to the state needs to be equal to the value given to the private entity. Each instance of appropriation for the benefit of a private entity is different, and DFA staff need to determine whether the state will be getting equal value in return for its appropriation.

As an example, the legislature could appropriate money for a homeless shelter run by a nonprofit entity in Bernalillo County. The county needs to own the building, and the nonprofit entity can lease the building from the county at fair market value. The lease can be paid off by the nonprofit in several ways, including providing insurance, security, maintenance or cash for the lease. It can also provide services that the county contracts for, like providing a homeless shelter for individuals. The DFA requires a fair market value lease for every project intended to benefit a nonprofit entity that demonstrates adequacy of consideration.

Representative Arnold-Jones asked whether these restrictions apply to boys' and girls' clubs, which are tax-exempt organizations that provide much-needed services to cities and counties. Ms. Amer said that it does not matter if the entity is for-profit or nonprofit; what matters is that the state receives sufficient consideration for the amount of the appropriation.

Speaker Lujan asked how the DFA oversees agreements between nonprofit entities and local governments. Ms. Amer said that the LGD enters into a grant agreement with a local government, contingent on the government having a lease agreement with the nonprofit. The DFA counsel reviews the agreement, which needs to provide an itemized list of monthly expenses and considerations. The LGD, however, does not audit whether the services to be provided by the nonprofit actually are performed. That responsibility lies with the local government and the contracting nonprofit.

Representative Sandoval expressed concern that a nonprofit entity that contracts to provide services for a local government will end up with not enough money to pay its staff, if that entity is required to offset its revenue from the government with lease payments.

Mr. Apodaca said that currently there are 400-500 LGD projects that are facing anti-donation issues. Each project takes many hours of staff time to resolve.

Reauthorization Restrictions and Current Issues

Mr. Apodaca and Ms. Gregorio discussed with the subcommittee the continuing problems associated with reauthorizations of capital projects. Some of the concerns include:

- a huge increase in the number of reauthorizations, from 44 in 1998 to 444 in 2008;
- the practice of taking one appropriation and reauthorizing it into several separate projects;
- reauthorizations for projects that have minimal funds remaining;
- reauthorizations of projects that have valid, binding contracts in place, leaving projects only partially completed;
- there is no ability for LGD or LCS staff to readily access the current balances of projects, since all appropriations are paid on a reimbursement basis, and most departments only report quarterly;
- the extensive amount of staff time required to research each reauthorization, which leads to overextended staff and errors in researching projects; and
- the haphazard capital outlay process, including reauthorizations, having a negative impact on the state's bond rating.

Senator Duran asked how it is possible that nobody knows how much money is available for a project at any given time. Mr. Apodaca said that local governments do not always submit invoices in a timely manner. In addition, even though an invoice may not have been submitted or the money spent, a local government may have already contracted for that money to be spent. Problems occur when the Capital Projects Monitoring System (CPMS) reports that money remains unspent on a project, even though it has been committed, and the legislature reauthorizes that money to another project.

Representative Saavedra agreed and said that many times the quarterly capital report shows large sums unspent on a project when in fact the project is already complete. Ms. Gregorio said that the CPMS can never be a real-time system, because it only reports the reimbursements that the DFA distributes and not the money being spent by the local government.

Ms. Gregorio presented a list of proposed reauthorization reforms to the subcommittee, which included some reforms that were adopted in 2007. The proposed changes include:

- No reauthorizations will be written for projects with balances under \$20,000, or for projects that already have valid contracts in place. (Adopted in 2007, with a minor language change proposed in 2008.)
- Reauthorizations can only be made once, except to fix errors. (Adopted in 2007.)
- Change the reauthorization deadline to December 15.
- Money cannot be split into several projects once it has been authorized for a project.

Members of the subcommittee expressed concern about implementing all of the proposed reform changes. Staff was directed to revisit the issue for the subcommittee's consideration at the October meeting.

Criteria for Statewide and Local Capital Projects

Mr. Gaudet, Ms. Leger and Renee Borrego of the LGD reviewed for the subcommittee the state and local criteria that has been used in the past two years as a guide in choosing capital outlay projects. Mr. Gaudet presented the local criteria and Ms. Leger presented the state criteria, with suggestions for a few minor language changes.

Representative Arnold-Jones asked how the Uniform Funding Application (UFA) for water projects could be integrated into the capital outlay request process. Mr. Apodaca said that his division is looking into that issue. Representative Arnold-Jones also suggested that DFA staff should work with newly elected legislators to meet with their local government officials to learn about needed capital outlay projects.

Senator Snyder suggested that LCS staff revise the language in the local criteria list to clarify that new projects should consider asking for planning and design money first and then

construction money later.

20. The subcommittee agreed to change its October meeting date from October 8 to October

There being no further business, the subcommittee adjourned at 4:30 p.m.